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Mandatory arbitration for customers but not for peers: A study of arbitration clauses in consumer and non-consumer contracts

by THEODORE EISENBERG, GEOFFREY P. MILLER, and EMILY SHERWIN

Mandatory arbitration clauses have been in the spotlight recently, as consumer advocates have challenged their legitimacy. Popular consumer products such as cellular phone service, credit cards, and discount brokerage often come with fine print contracts in which the customer agrees to submit disputes to arbitration rather than to litigate in court. Typically, the customer also agrees not to participate in aggregate proceedings such as class actions, either in court or before an arbitrator.

Another common contract provision makes arbitration clauses and class arbitration waivers non-severable, so that if an arbitrator authorizes claimants to aggregate their claims, they must instead proceed in court. The combined effect of these contractual provisions is to ensure that consumers will pursue claims individually and before arbitrators, if at all. Mandatory arbitration clauses also ensure that disputes between firms and consumers will not be decided by juries.

Not surprisingly, firms that include arbitration clauses in their contracts with consumers have taken a strong public stand on the benefits of arbitration, not only for themselves but for their customers. In litigation testing the validity of mandatory consumer arbitration, briefs on behalf of corporate defendants and industry groups repeatedly assert that arbitration saves both parties time and money and yields fair results for consumers.¹ Proponents of mandatory arbitration cite high levels of satisfac-

tion and favorable win-rates for claimants,² and add that reducing the costs of dispute resolution for firms means lower prices for consumers.³

Mandatory arbitration clauses appeared in more than three-quarters of consumer contracts examined but in less than one-tenth of non-consumer contracts negotiated by the same firms, suggesting that the firms' faith in arbitration is considerably weaker than they have claimed.

Opponents argue that mandatory arbitration clauses are imposed on consumers without full consent and that arbitration deprives consumers of jury trials, reduces awards, and fails to advance the public's interest in deterrence and law reform.⁴ More pointedly, opponents object to the use of arbitration clauses to curtail aggregate proceed-

ings. Without the option of aggregate dispute resolution, they maintain, small claims are not financially viable in any forum. As a result, firms will escape

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1. See, e.g., Brief of CTIA—The Wireless Association as Amicus Curiae in Support of Affirmance 2, *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007); Brief of Respondent Cingular Wireless 39, *Scott*, *supra*; Discover Bank's Answer to Amicus Curie [sic] Brief of Consumer Attorneys of California in Support of Real Party in Interest 13-14, *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005); Brief of Amici Curiae American Bankers' Ass'n., Am. Financial Services Ass'n., & Consumer Bankers' Ass'n. in Support of Petitioner Discover Bank 7, *Discover*, *supra*.

CARD AGREEMENT

ARBITRATION:

PLEASE READ THIS PROVISION OF THE AGREEMENT CAREFULLY. IT PROVIDES THAT ANY DISPUTE MAY BE RESOLVED BY BINDING ARBITRATION. ARBITRATION REPLACES THE RIGHT TO GO TO COURT, INCLUDING THE RIGHT TO A JURY AND THE RIGHT TO PARTICIPATE IN A CLASS ACTION OR SIMILAR PROCEEDING. IN ARBITRATION, A DISPUTE IS RESOLVED BY AN ARBITRATOR INSTEAD OF A JUDGE OR JURY. ARBITRATION PROCEDURES ARE SIMPLER AND MORE LIMITED THAN COURT PROCEDURES.

Agreement to Arbitrate:

Either you or we may, without the other's consent, elect mandatory, binding arbitration for any claim, dispute, or controversy between you and us (called "Claims").

liability for misconduct that imposes small per capita losses on large numbers of consumers.⁵ Judicial responses to mandatory arbitration have been mixed, although several state courts have recently found particular arbitration provisions unconscionable.⁶

Against this background, we conducted a study of contractual practices by well-known firms marketing consumer products, comparing the firms' consumer contracts with contracts the same firms negotiated with business peers. The frequency of arbitration clauses in consumer contracts has been studied before, as has the frequency of arbitration clauses in non-consumer contracts.⁷ Our

study is the first to compare the use of arbitration clauses within firms, in different contractual contexts.

The results are striking: in our sample, mandatory arbitration clauses appeared in more than three-

quarters of consumer contracts and less than one tenth of non-consumer contracts (excluding employment contracts) negotiated by the same firms. This suggests that the firms' faith in arbitration is considerably weaker than they have claimed. For the purpose of business-to-business disputes, in which they may be either plaintiffs or defendants, they prefer the option to litigate in court.

We approached our project with several hypotheses in mind. First, because the firms we studied, or trade organizations to which they belong, have publicly endorsed arbitration as speedy, cost-effective, and fair, and because speed, cost-effectiveness, and fairness are desirable in any contractual dispute, one would expect firms to provide consistently for arbitration in contracts of all types. Second, because businesses have often expressed a skeptical view of the reliability of juries as fact-finders, one would expect firms to provide consistently for non-jury trials, even in the absence of mandatory arbitration provisions. Neither of these hypotheses were confirmed by our data. Instead, both the firms' preference for arbitration and their aversity to jury trials pertained primarily to disputes with consumers.

The study

To conduct the study, we first identified firms with significant market

2. See, e.g., Lisa B. Bingham, *Is There a Bias in Arbitration of Nonunion Employment Disputes?: An Analysis of Active Cases and Outcomes*, 6 INT'L J. CONFLICT MGMT. 369, 378 (1995) (reporting favorable employee win-rates in employment-related arbitration); Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 45-51 (1998) (citing studies of win-rates, awards, and participant satisfaction in arbitration and litigation); Eric J. Mogilnicki & Kirk D. Jensen, *Arbitration and Unconscionability*, 19 GA. ST. U. L. REV. 761, 763-65 (2003) (citing studies of outcomes in arbitration and litigation).

3. See, e.g., Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISPUTE RESOLUTION 89 (2001).

4. Richard M. Alderman, *Pre-dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUSTON L. REV. 1237 (2001); Mark E. Budnitz, *The High Cost of Mandatory Arbitration*, 67 LAW & CONTEMP. PROBS. 133 (2004); Paul Carrington, *Unconscionable Lawyers*, 19 GA. ST. U. L. REV. 361 (2003); Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373 (2005); Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631 (2005).

5. Samuel Issacharoff & Erin F. Delaney, *Credit Card Accountability*, 73 U. CHI. L. REV. 158 (2006); Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 LAW & CONTEMP. PROBS. 75, 103 (2004).

6. See, e.g., *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007).

7. See, e.g., Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Pre-dispute Arbitration Clauses*, 2004 LAW & CONTEMP. PROBS. 55 (2004) (finding that arbitration clauses appeared in 35% of a varied sample of consumer contracts); Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335 (2007) (finding that arbitration clauses appeared in 11% of material contracts of large corporate firms); Florencia Marotta-Wurgler, *"Unfair" Dispute Resolution Clauses: Much Ado About Nothing?*, in Omri Ben-Shahar (ed.) *BOILERPLATE: THE FOUNDATION OF MARKET CONTRACTS* 45, 47-48 (2007) (finding that arbitration clauses appeared in about 6% of 597 online end-user software licenses).

Table 1. Companies and contract types

Company	Contract type		Material contracts	Total
	Consumer	Employment		
AT&T	1	0	17	18
Alltel	1	0	12	13
American Express	1	0	8	9
Ameriprise	1	0	7	8
Ameritrade	1	6	8	15
Bank of America	1	0	6	7
Cablevision	3	0	7	10
CellularOne	1	3	9	13
Charles Schwab	2	0	11	13
Charter Commun.	1	1	9	11
Chase	2	0	6	8
Citigroup	2	0	2	4
Comcast	1	0	10	11
Cox	1	0	1	2
ETrade	1	0	1	2
GE/GE Money Bank*	1	0	8	9
Qwest	1	1	7	9
Sprint	1	3	3	7
Time Warner	1	0	10	11
U.S. Cellular	1	0	5	6
Verizon	1	0	3	4
Total	26	14	150	190

*GE Money Bank describes itself as "the consumer and small business financial services unit of General Electric." http://www.gemoney.com/about_us/index.html, accessed Dec. 14, 2007.
Sources. Authors' collection of consumer contracts: EDGAR database Form 8-K and Form 10-K filings, Jan. 1, 2006 to Aug. 13, 2007.

Table 2. Rate of arbitration clauses by contract type

Contract type	Arbitration clause		Total
	No	Yes	
Consumer (N)	6	20	26
Percent	23.1	76.9	100.0
Employment (N)	1	13	14
Percent	7.1	92.9	100.0
Other material contract (N)	138	9	147
Percent	93.9	6.1	100.0
Total (N)	145	42	187
Percent	76.3	23.7	100.0

Sources. Authors' collection of consumer contracts: EDGAR database Form 8-K and Form 10-K, Jan. 1, 2006 to Aug. 13, 2007.

shares or name recognition in the sectors of telecommunications, consumer credit, and discount brokerage (see Table 1). Most of the firms are on *Fortune* magazine's list of the top 100 American companies; others are close to the top 100 or well-known within their industry sector.

We then collected consumer agreements drafted and used by each firm to regulate ongoing relationships between the firm and consumers of its services. The contracts we studied were current in July and August, 2007. Some were available to anyone visiting the firm's web site; others

were available through a link or window that appeared in the process of placing an order; others were available only by mail after completing an order.⁸

Next, we searched for non-consumer contracts entered into by the same firm in a data base of required SEC filings (forms 8-K and 10-K) from January 1, 2006 to August 13, 2007. (Firms registered with the SEC must file current and annual reports listing, among other things, contracts that materially affect the company's financial condition.) Typical filings included stock purchase agreements, credit and security agreements, and pooling and service agreements for loans. Material contracts filed with the SEC also included employment agreements (usually with key employees) and related agreements governing benefits and incentives. The economic significance of all these contracts suggests that they were negotiated with care.

Our study covered 21 firms. Seven of these provide cellular phone service, five provide "triple play" cable service (CATV, Internet, and phone), four provide brokerage service, and five are banks or finance companies issuing credit cards to consumers. We reviewed 26 consumer contracts and 164 non-consumer contracts. Fourteen of the non-consumer contracts related to employment. Because employment contracts differed significantly from other non-consumer contracts in their treatment of arbitration, we segregated these contracts for separate analysis.

We coded both consumer and non-consumer contracts for the presence of mandatory arbitration

8. For example, Walmart (*Fortune's* #1) provides credit card applicants with a "disclosure" statement at the time of application, then mails the full consumer agreement to the customer when the application is accepted. Telephone requests for an advance copy of the agreement, prior to submission of an application containing personal financial information, were declined on the ground that the company did not furnish its contracts to "just anyone." Telephone conversation with Walmart customer service June 15, 2007. The consumer contract that Walmart sends is in fact a contract with GE Money Bank.

clauses, class action waivers, jury trial waivers, choice of law provisions, forum selection clauses, and provisions for payment of costs, including attorney's fees. If the contract required arbitration, we coded for waivers of class arbitration, rules governing arbitration, arbitration venue selection, and provisions on fees. We also noted and coded for a common non-severability provision stating that in the event aggregate proceedings are authorized in arbitration, arbitration is no longer required.

Most significantly, we found that more than 75 percent of consumer contracts in our sample included mandatory arbitration clauses, while fewer than 10 percent of non-consumer agreements provided for arbitration (see Table 2). Excluding employment contracts, which required arbitration at a very high rate (90 percent), the comparison is more dramatic: fewer than 6 percent of non-employment, non-consumer contracts provided for arbitration. Only 8 of our 21 firms provided for arbitration in any non-employment, non-consumer contracts, and no firm provided for arbitration in more than one such contract. Thus, in our sample, firms overwhelmingly selected arbitration as the method for resolving consumer disputes but left open the choice of litigation in business-to-business disputes.

Class-action waivers

Our findings on provisions relating to aggregation of claims are also significant (see Tables 3, 4, and 5). Every consumer contract with a mandatory arbitration clause also included a waiver of the right to participate in class-wide arbitration, and 60 percent of consumer contracts with mandatory arbitration clauses provided that in the event of class arbitration, the arbitration clause would no longer be effective. Thus, if a court or arbitrator authorized claimants to arbitrate as a class the firm could elect to litigate instead. Eighty percent of consumer contracts also provided independently for a

Table 3. Pattern of class arbitration waiver in contracts with arbitration clauses

Contract type	Class arbitration waiver		
	No	Yes	Total
Consumer (N)	0	20	20
Percent	0	100.0	100.0
Employment (N)	13	0	13
Percent	100.0	0.0	100.0
Other material contract (N)	5	2	7
Percent	71.4	28.6	100.0
Total (N)	18	22	40
Percent	45.0	55.0	100.0

Table 4. Pattern of void arbitration clauses in the event of class action arbitration

Contract type	Arbitration clause void if class arbitration permitted clause void		
	No	Yes	Total
Consumer (N)	8	12	20
Percent	40.0	60.0	100.0
Employment (N)	13	0	13
Percent	100.0	0.0	100.0
Other material contract (N)	7	0	7
Percent	100.0	0.0	100.0
Total (N)	28	12	40
Percent	70.0	30.0	100.0

Table 5. Pattern of class action waiver in contracts with arbitration clauses

Contract type	Class action waiver		
	No	Yes	Total
Consumer (N)	4	16	20
Percent	20.0	80.0	100.0
Employment (N)	13	0	13
Percent	100.0	0.0	100.0
Other material contract (N)	5	2	7
Percent	71.4	28.6	100.0
Total (N)	22	18	40
Percent	55.0	45.0	100.0

Sources for Tables 3, 4, and 5. Authors' collection of consumer contracts: EDGAR database Form 8-K and Form 10-K filings, Jan. 1, 2006 to Aug. 13, 2007.

waiver of the right to litigate as a class. Yet, in the approximately 23 percent of consumer contracts that did not require arbitration of disputes, there

were no class action waivers.

Non-consumer contracts looked quite different. Among the 90 percent of employment-related contracts that

Table 6. Summary of jury trial waiver clauses by contract type

Contract type	Sample limited to contracts without arbitration clauses		Arbitration clauses treated as jury trial waivers	
	(1)	(2)	(3)	(4)
	No jury trial waiver	Jury trial waiver	No jury trial waiver	Jury trial waiver
Consumer (N)	6	0	6	20
Percent	100.0	0	23.1	76.9
Employment (N)	1	0	1	13
Percent	100.0	0	7.1	92.9
Other material contract (N)	103	35	103	44
Percent	74.6	25.4	70.1	29.9
Total (N)	110	35	110	77
Percent	75.9	24.1	58.8	41.2

Sources. Authors' collection of consumer contracts: EDGAR database Form 8-K and Form 10-K filings, Jan. 1, 2006 to Aug. 13, 2007. Columns (3) and (4) treat arbitration clauses as jury trial waivers.

provided for arbitration, none precluded class proceedings. Among the few non-employment, non-consumer contracts that required arbitration, only 28 percent provided for a waiver of class arbitration and none provided for a waiver of class litigation or for a litigation option in case class arbitration was approved.⁹ Thus, our firms consistently provided against aggregation of consumer claims, but did not rule out aggregate proceedings in employment-related and business-to-business disputes.

Jury-trial waivers

Finally, we found that most non-consumer contracts that did not contain arbitration clauses (75 percent) also did not contain jury-trial waivers (see Table 6). Again, consumer contracts looked quite different: treating mandatory arbitration clauses as effective waivers of the right to a jury trial, more than 75 percent of consumer contracts provided for non-jury fact-finding. It appears that firms preferred to eliminate jury trials in consumer disputes (as well as employment disputes) but preserve jury trial rights in business-to-business disputes.

Marked variation

In sum, despite their rhetorical

stance in favor of arbitration, the firms in our sample did not uniformly include arbitration clauses in their contracts. Instead, the use of arbitration clauses varied markedly according to the contract type: arbitration clauses appeared routinely in employment contracts (92.9 percent), frequently in consumer contracts (76.9 percent), and rarely in non-employment, non-consumer business contracts (6.1 percent). In consumer contracts, mandatory arbitration clauses were coupled uniformly with provisions barring class arbitration, and frequently with non-severability clauses and waivers of class litigation.

This pattern suggests that firms do not in fact view arbitration as a generally superior method of dispute resolution that can save time and money without affecting the fairness of outcomes. Rather, for the purpose of resolving important business-to-business disputes, they prefer the option of litigation, without limits on process. Admittedly, there are objective differences between consumer disputes and disputes that arise under material business contracts. When negotiating contracts, business parties may be reluctant to demand arbitration because the demand might be taken as signaling a propen-

sity to breach; they might also anticipate that in the event of breach, they can agree to arbitrate if arbitration appears preferable. Business parties may also prefer to preserve their options, reasoning that the nature and complexity of disputes arising under major contracts is difficult to predict. Yet, consumer disputes can be complex as well, and can develop in unpredictable ways. Accordingly, we believe the most plausible explanation for the contractual patterns we observed is also the simplest: outside the context of consumer disputes, firms view arbitration as a less desirable option than litigation.

We note that in one category of non-consumer contracts—employment related contracts—firms strongly favored arbitration over litigation. This preference, however, appears to be due to the fact that senior employees and their corporate employers have a common interest in keeping the details of their disputes confidential; therefore both are likely to prefer private arbitration over litigation in a public forum.

Motives

In addition to implying that the public support consumer-sector firms have voiced for arbitration does not extend to non-employment, non-consumer disputes, our data lend support to the argument that a significant motive for mandatory arbitration clauses in consumer contracts is to prevent aggregation of consumers' claims. Data aside, this is a plausible argument. For several reasons, firms naturally prefer to face consumer claims individually rather than in aggregate proceedings. Aggregation of claims creates settlement pressure, as firms seek to avoid the risk of a large damage award. Moreover, when the damage caused to each consumer is small, individual claims may not be viable, even in arbitration. If so, avoiding an aggregate proceeding may mean avoiding liability altogether. Yet, a

9. In these respects, the differences between consumer agreements and non-consumer agreements are statistically significant at $p < 0.001$.

straightforward contractual waiver of class-wide dispute resolution might be invalidated by courts on grounds of unconscionability, and in any event a direct attempt to suppress aggregate claims might be unwise from the standpoint of public relations.

Arbitration clauses, in contrast, allow firms to argue that they are adopting dispute resolution procedures in the best interest of their customers. Moreover, arbitration clauses are protected by a federal policy in favor of arbitration, which courts have adopted by interpretation of the Federal Arbitration Act. Thus, a class action waiver embedded in an arbitration clause may have a better chance of survival than a class action waiver standing alone.¹⁰

Our data, while not conclusive, tend to confirm this account of company motives. As noted, most of the consumer contracts studied contained both mandatory arbitration clauses and class waiver provisions. This correlation did not hold true in employment contracts, which typically contained mandatory arbitration clauses but no class waiver provisions. Although the sample of non-employment, non-consumer agreements with arbitration clauses was rather small (9), only two of these contracts combined arbitration with a class waiver provision.

A further point is that a majority of consumer contracts (and no other contracts) contained nonseverability clauses, which eliminated the arbitration requirement in the event of a judicial or arbitral decision to authorize class arbitration. Thus, it appears that when consumers proceed as a class, firms prefer litigation over arbitration. We can speculate about various reasons for this preference: firms may expect courts to apply stricter class certification requirements than arbitrators; defense lawyers may have

more experience with class litigation than with class arbitration and prefer to proceed on familiar ground; firms may fear that arbitrators will be inclined to split the difference between parties rather than rule decisively in their favor; and firms may wish to preserve their right to appeal large judgments. In any event, the high incidence of these clauses in consumer contracts suggests that from the firms' point of view, concerns about class arbitration by consumers quickly overwhelms whatever benefits arbitration may hold.

The high incidence of arbitration clauses in the particular types of consumer contracts we studied also provides indirect support for the theory that firms use mandatory arbitration clauses as a strategy to suppress aggregate proceedings by consumers. Other studies suggest that the rate of arbitration clauses in consumer contracts varies by industry type: in some categories (including ours) arbitration clauses are prevalent; in others they are comparatively rare. For example, in a 2004 study of consumer contracts by Linda Demaine and Deborah Hensler, the rate of arbitration clauses in 21 contract categories was less than 10 percent, while the overall rate was 35 percent—less than half the rate we observed.¹¹ To some extent, this variation may reflect industry concentration: the sectors we studied (cellular phone service, telecommunications, credit cards, discount brokerage) are dominated by a small number of firms, making it harder for consumers to shop for terms. More significantly, in the sectors we studied, firm practices and policies are particularly likely to cause minor harms to many similarly situated customers. As a result, firms in these sectors have particular reason to avoid class claims: consumers who are not likely to proceed individually against the firm present a substantial economic threat when they are able to aggregate their claims. In contrast, firms in sectors for which rate of arbitration clauses is low (rental property managers, grocers, restaurants, and the like) are less likely to face class claims for small individual losses.

Our data are also consistent with the view that firms are suspicious of juries as fact-finders in consumer disputes, and use arbitration clauses to avoid them. Overall, we found a fairly low rate of jury trial waivers in our sample of contracts (just over 25 percent in contracts without arbitration clauses). However, arbitration clauses, which appeared in more than 75 percent of consumer agreements, effectively preclude jury trials. Thus, firms may view mandatory arbitration as a way to circumvent both aggregation of claims and fact-finding by juries, under the guise of a consumer-friendly mechanism for dispute resolution.

Overall, our study suggests that the asserted benefits of arbitration—fair outcomes arrived at faster and at lower cost—are not the dominant motives for inclusion of arbitration clauses in consumer contracts in the industries we studied. Firms that required arbitration of consumer disputes did not favor arbitration in their non-consumer contracts. The most likely explanation for the pattern we observed is that firms value arbitration clauses for their effects in suppressing aggregate proceedings by consumers, and perhaps averting liability for widespread but low-value wrongs. ❧

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10. Gilles, *supra* n. 4 (describing a dramatic rise in the use of arbitration clauses in the wake of favorable federal decisions, coincident with an increase in corporate anxiety over consumer class actions).

11. Demaine & Hensler, *supra* n. 7, at 63-64.